28

FILED

AUG 15 2007

OFFICE OF THE CLERK
SUPREME COURT, U.S

No. 06-43

IN THE

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,
Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. AND MOTOROLA, INC.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF ORGANIZATION FOR INTERNATIONAL INVESTMENT, INTERNATIONAL CHAMBER OF COMMERCE AND FEDERATION OF GERMAN INDUSTRIES AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

STUART J. BASKIN*
HERBERT S. WASHER
ADAM S. HAKKI
SHEARMAN & STERLING LLP
599 Lexington Avenue
New York, NY 10022
(212) 848-4000
Attorneys for Amici

August 15, 2007

*Counsel of Record

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

INTERESTS OF THE *AMICI CURIAE* 1

SUMMARY OF ARGUMENT 3

ARGUMENT 4

I. RESPONDENTS' LIABILITY UNDER SECTION 10(B) WOULD BE INCONSISTENT WITH THE DECISIONS OF THIS COURT AND CONGRESS 4

II. PETITIONERS' PROPOSED "SCHEME LIABILITY" WILL DETER FOREIGN COMPANIES FROM DOING BUSINESS WITH U.S. COMPANIES 11

A. Recent Studies Indicate that Foreign Companies Will Be Deterred from Engaging in Business Transactions with U.S. Public Companies 13

B. Commentators at Home and Abroad Agree that Petitioners' Approach to "Scheme Liability" Would Deter Foreign Companies from Engaging in Transactions with U.S. Companies 17

C. Foreign Countries Do Not Follow the Approach to Scheme Liability Advocated by Petitioners 21

1. United Kingdom 21

2. Canada 22

3. Germany 23

CONCLUSION 24

TABLE OF AUTHORITIES

CASES

In re Alstom SA Sec. Litig., 406 F. Supp. 2d 433 (S.D.N.Y. 2005) 7

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) 9, 10, 12

Cent. Bank, N.A. v. First Interstate Bank, N.A., 511 U.S. 164 (1994) ..... *passim*

Dura Pharm, Inc. v. Broudo, 544 U.S. 336 (2005) 8

In re Dynegy Sec. Litig., 339 F. Supp. 2d 804 (S.D. Tex. 2004) 7

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) 6, 10

Feldman v. Pioneer Petroleum, Inc., 813 F.2d 296 (10th Cir. 1987) 6

K&S P'ship v. Cont'l Bank, N.A., 952 F.2d 971 (8th Cir. 1991) 6

Landy v. FDIC, 486 F.2d 139 (3d Cir. 1973) 6

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71 (2006) 12

Pinter v. Dahl, 486 U.S. 622 (1988) 9

Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) 6

Stoneridge Inv. Partners, LLS v. Scientific-Atlanta Inc., 443 F.3d 987 (8th Cir. 2006) 5, 7, 12, 17

United States v. O'Hagan, 521 U.S. 642 (1997) 6

Virginia Bankshares v. Sandberg, 501 U.S. 1083 (1991) 10

STATUTES

15 U.S.C. § 78t(e) 4

15 U.S.C. § 78u-4(b)(4) 8

15 U.S.C. § 78u (h)(9)(B) (1934) 17

18 U.S.C. § 2 17

Financial Services and Markets Act of 2000 ..... 21, 22

German Securities Trading Act 23

German Securities Trading Act, §37(b) 23

German Securities Trading Act, §37(c) 23

S. Rep. No. 104-98 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 698 4

R.S.O. 1990, c. S.5 ss. 130, 130.1 and 131 22

R.S.O. 1990, c. S. 5 s. 138.3 23

MISCELLANEOUS

A Wave of U.S. Class Actions Threatened, HANDELSBLATT, August 1, 2007 20

Commentary, *Down on the Street*, ECONOMIST, Nov. 23, 2006 (*available at* http://www.economist.com/business/displaystory.cfm?story_id=8316406) 11

Committee on Capital Markets, *Interim Report of the Committee on Capital Markets Regulation* (Nov. 30, 2006) (*available at* http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf) 13, 15

Dick Thornburgh, Commentary, *Class Action Gamesmanship*, WASH. TIMES, June 15, 2007 ..... 18, 19

Editorial, *Transatlantische Beziehungen in Gefahr* [*Transatlantic Relations in Danger*], BOERSENZEITUNG, June 28, 2007 ..... 19, 20

Hearing Before the Sub. Comm. on Banking, Hous. And Urban Affairs, 107th Cong. 1037 (2002) 4

Ian Swanson, *Foreign Executives Press for Reform of Litigation in United States*, THE HILL, May 18, 2007 20

Michael R. Bloomberg and Charles E. Schumer, *Sustaining New York's and US' Global Financial Services Leadership* (Jan. 22, 2007) (*available at* http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf) 13, 14, 15

PricewaterhouseCoopers 2006 Securities Litigation Study (*available at* http://www.pwc.com/extweb/pwcpublications.nsf/docid/a89d7b2aa156e4f1852572ce005bbd54) 16

Restatement (Second) Torts § 876(b) (1977) 6

Senate Republican Policy Committee, *Excesses Threaten U.S. Competitiveness, When Excess Damages Success: Have Litigation, Taxation, and Regulation Gone Too Far*, June 19, 2007 13

Stephen Labaton, *Investors' Suits Face Higher Bar, Justices Rule*, N.Y. TIMES, June 22, 2007 18

The State of the International Financial System: Hearing Before the H. Comm. on Financial Services (2007) (Testimony of Henry Paulson) (*available at* http://financialserv.edgeboss.net/wmedia/financialserv/hearing062007.wvx) 18

The Stoneridge Showdown, ECONOMIST, June 16, 2007 (*available at* http://www.economist.com/finance/displaystory.cfm?story_id=9340553) 19

Tim Shipman, *Stoneridge Court Case Threatens Trade with U.S.*, SUNDAY TELEGRAPH, July 7, 2007 (*available at* http://www.telegraph.co.uk/news/main.jhtml?xml=/news/2007/07/08/wlitig108.xml).....18

U.S. Chamber of Commerce, *Commission on the Regulation of U.S. Capital Markets in the 21st Century: Report and Recommendations* (Mar. 2007) (*available at* http://www.uschamber.com/publications/reports/0703capmarketscomm.htm) 13

William H. Donaldson, Chairman, SEC, U.S. Capital Markets in the Post-Sarbanes-Oxley World: Why Our Markets Should Matter to Foreign Issuers, London, England (Jan. 25, 2005), (*available at* http:www.sec.gov/news/speech/spch012505whd.htm).....5

INTERESTS OF THE *AMICI CURIAE*

Amici curiae are international business associations with substantial common interests in ensuring stable and predictable legal regimes affecting international trade and investment.[1] In aggregate, the organizations filing this brief represent a substantial proportion of all foreign entities doing business in the U.S. The *amici* are umbrella organizations charged with representing the legal and policy interests of their members and, as such, regularly file briefs in the U.S. as *amici curiae* in cases such as this one that raise issues of vital concern to the foreign business community. Although the *amici* rarely file a brief in a case that does not directly address foreign trade, they have decided to do so here because of the significant impact a ruling in this case could have on foreign companies that seek to do business in the United States.

The Organization for International Investment ("OFII") is the largest business association in the U.S. representing the interests of U.S. subsidiaries of multinational companies before all branches and at all levels of government. OFII's member companies operate throughout the U.S., employing hundreds of thousands of workers in thousands of plants and locations throughout the country, as well as in many foreign countries, and are affiliates of companies transacting business in countries around the world.

The International Chamber of Commerce ("ICC") is the world business organization representing thousands of companies, chambers of commerce and business associations in 130 countries. Among other functions, the ICC promotes

---

[1] No party's counsel wrote this brief (in whole or in part), and no person other than *amici* and their counsel contributed monetarily to this brief's preparation or submission. Petitioner's letter consenting to the filing of this brief is on file with this Court. Respondent's letter consenting to the filing is attached.

voluntary rules governing the conduct of business across borders that are observed in countless thousands of transactions every day; provides essential trade-related services such as the ICC International Court of Arbitration, the world's leading arbitral institution; and consults on issues of international trade for the United Nations and its specialized agencies.

The Federation of German Industries ("BDI") is the umbrella organization for all industrial businesses and industry-related service providers in Germany. It represents 37 industrial sector federations and has 15 regional offices in Germany. The BDI speaks for more than 100,000 private enterprises employing about eight million people.

Collectively, the members of the *amici* contribute substantially to the U.S. economy through investment and in commercial dealings with U.S. public companies. In 2006, the cumulative value of foreign direct investment ("FDI") in the U.S. was $1.874 trillion. This amount is equivalent to 15% of the U.S. gross domestic product ("GDP"). Direct investment capital inflows totaled $183.6 billion in 2006, $109.9 billion in 2005, and $133.2 billion in 2004. In addition, U.S. affiliates of foreign companies that are more than 50% owned by foreign investors employed 5.3 million U.S. workers in 2003, accounting for 4.7% of total private industry employment.

In connection with this activity, the members of *amici* engage in thousands of transactions each year with publicly traded companies in the U.S. The question presented by Petitioner in this case – whether counterparties to a transaction with a public company can be held liable for that company's misrepresentations to investors under Section 10(b) – is thus of fundamental importance to the members of *amici*.

SUMMARY OF ARGUMENT

Petitioner and its *amici* urge a broad expansion of liability under Section 10(b). Under Petitioner's proposed rule, anyone who participates in a transaction that has the "purpose and effect" of creating "a false appearance of material fact in furtherance of [a] scheme" can be held liable. Pet. Br. at i. This position should be rejected, as it would improperly permit aiding and abetting and conspiracy liability under Section 10(b).

The practical effect of Petitioner's position, if accepted, would be that any company that enters into a general commercial transaction could be held liable to a counterparty's shareholders under Section 10(b) if its counterparty misreports the transaction on its own financial statements. This result would obtain even though the "non-speaking" company correctly accounted for the transaction in its own financial statements and neither made representations nor owed any duties to the counterparty's shareholders.

This brief is not designed to provide a comprehensive discussion of the merits (or lack thereof) of Petitioner's "scheme" liability theory and "purpose and effects" test. Instead, *amici* seek to highlight that from the perspective of foreign companies in particular, Petitioner's view of Section 10(b) liability is unworkable, unpredictable, and plainly inconsistent with this Court's ruling in *Central Bank* and with the express intent of Congress. By virtue of its sweeping and ill-defined scope, it would convert parties to commercial transactions – including foreign companies in overseas transactions with U.S. entities – into *de facto* auditors of their U.S.-listed counterparty's financial statements, tasked with ensuring that their counterparty properly accounts for the transaction. Foreign companies, which generally do not employ U.S. GAAP, are particularly ill-suited to the task.

As a consequence, the imposition of scheme liability would have a material chilling effect on the willingness of foreign

companies to engage in general commercial transactions with publicly-listed U.S. companies. Numerous studies indicate that many companies avoid publicly registering their securities in the United States due to the costs and risks associated with the U.S. legal system. The rule Petitioner proposes would take this problem one step further by making foreign and other companies more reluctant even to do ordinary business with companies that publicly list in the United States.

ARGUMENT

I. RESPONDENTS' LIABILITY UNDER SECTION 10(B) WOULD BE INCONSISTENT WITH THE DECISIONS OF THIS COURT AND CONGRESS

This Court in *Central Bank* rejected a private right of action under Section 10(b) against aiders and abettors, finding that Congress did not intend the statute to reach such conduct. The following year, Congress specifically considered including a provision in the Private Securities Litigation Reform Act (the "PSLRA") that would restore aiding and abetting liability.

Ultimately, Congress concluded that only the SEC – which, unlike private plaintiffs, does not possess a profit motive and is charged with considering the market impact of its actions – should have the right to bring claims against those who aid and abet securities fraud.[2] 15 U.S.C. § 78t(e). *See also* S. Rep. No. 104-98, at 19 (1995), as reprinted in 1995 U.S.C.C.A.N. 679, 698 ("The Committee considered testimony endorsing the result in Central Bank and testimony seeking to overturn this decision. The Committee believes

---

[2] Congress did so again in 2002 when, in the wake of Enron's collapse and other cases of accounting fraud, it rejected renewed calls "to restore aiding and abetting liability for those who contribute to fraud." Hearing Before the Sub. Comm. on Banking, Hous. And Urban Affairs, 107th Cong. 1037 (2002) (quoting former Senator Metzenbaum).

that amending the [Exchange] Act to provide explicitly for private aiding and abetting liability would be contrary to S. 240's goal of reducing meritless securities litigation.").

Congress thereby left the policing of aiders and abettors to a U.S. regulatory and enforcement system that is widely regarded as the most comprehensive in the world. *See* William H. Donaldson, Chairman, SEC, U.S. Capital Markets in the Post-Sarbanes-Oxley World: Why Our Markets Should Matter to Foreign Issuers, London, England, Jan. 25, 2005, http:www.sec.gov/news/speech/spch012505whd.htm ("[S]ince the 1930s, the U.S. has required some of the most extensive financial disclosures, backed up by one of the most robust enforcement regimes of any jurisdiction in the world."). In so doing, Congress struck a careful balance between protecting investors and promoting a healthy and robust U.S. economy.

Plaintiffs' lawyers, displeased with Congress' judgment, sought ways to redefine as primary violators those who traditionally had been considered aiders and abettors. The *Stoneridge* case is a textbook example of this effort. As Petitioner acknowledges, Charter shareholders allegedly were deceived by misleading financial statements prepared and disseminated by Charter. They did not know about the transactions between Charter and the Respondents that are the subject of the complaint. (*E.g.*, Br. for Pet'r at 15; *see also id.* at 28 (conceding that "Respondents . . . did not themselves make misrepresentations or omissions to investors")). Respondents made no statements to Charter shareholders and owed no legal duty to do so; their only role was as counterparty to transactions that Charter allegedly mischaracterized in its financial statements.

Traditionally, such a case would be considered one of "misstatement" brought under Rule 10b-5(b). Charter would be the primary violator, and the Respondents universally would be regarded as, at most, (if proven) aiders and abettors of Charter's violation. *See, e.g., K&S P'ship v. Cont'l Bank,*

N.A., 952 F.2d 971, 976-77, 979-80 (8th Cir. 1991) (participation in business transactions challenged as "substantial assistance" in furtherance of primary violation); *Feldman v. Pioneer Petroleum, Inc.*, 813 F.2d 296, 301 (10th Cir. 1987) ("Plaintiffs also alleged that Fidelity Bank, N.A. and its president . . . aided and abetted in a conspiracy to promote the scheme by engaging in a fraudulent and deceptive transaction . . . ."); *see also Landy v. FDIC*, 486 F.2d 139, 163 (3d Cir. 1973) (addressing whether the "substantial assistance" component of aiding and abetting was satisfied where the secondary actor engaged in "a business transaction . . . which foreseeably permits one of the parties to it . . . to independently engage in illegal action"); Restatement (Second) Torts § 876(b) (1977) (defendant aids and abets when "he . . . knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself").

To avoid the *Central Bank* and PSLRA bar on private actions for aiding and abetting, Petitioner has sought to re-label the violation. Instead of pursuing a "misstatement" claim under Rule 10b-5(b), it alleges a "scheme" to make a misstatement under Rule 10b-5(a). That subsection makes it unlawful to use or employ any "device, *scheme* or artifice to defraud." (emphasis added) The argument then is that all who take part in the purported "scheme" (whether they directly deceive shareholders or not) are primary violators rather than aiders and abettors.[3]

This argument is nothing more than alchemy performed with the use of labels. Many courts confronted with this

---

[3] Of course, the language of Section 10(b) itself, rather than the SEC's Rule 10b-5, defines those who can be considered primary violators. This Court has consistently held that the language of Rule 10b-5 cannot be used to expand liability beyond the scope permitted by Section 10(b) itself. *See United States v. O'Hagan*, 521 U.S. 642, 651 (1997); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 472-74 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976).

tactic have correctly recognized that the "scheme" label cannot transform an aider and abettor into a primary violator. *Stoneridge Inv. Partners, LLS v. Scientific-Atlanta Inc. (In re Charter Communications, Inc. Sec. Litig.)*, 443 F.3d 987, 991-92 (8th Cir. 2006); *see also In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 476 (S.D.N.Y. 2005) (claiming defendants were part of scheme to make misstatements "would result in the circumvention of . . . Central Bank's prohibition of aider and abettor liability); *In re Dynegy Sec. Litig.*, 339 F. Supp. 2d 804, 916 (S.D. Tex. 2004) ("[P]laintiffs cannot invoke subsections (a) and (c) of Rule 10b-5 to circumvent Central Bank's limitations on liability for a secondary actor's involvement in the preparation of false and misleading statements.").

Labels aside, civil liability under Section 10(b) can and should be determined by the test established by this Court in *Central Bank*: "Any person or entity . . . who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met." 511 U.S. at 191.

As this Court observed in *Central Bank*, a fundamental defect in aiding and abetting liability is that it permits Section 10(b) liability where the essential elements of securities fraud have not been shown as to each defendant. Petitioner's "scheme" theory reprises *precisely* that defect.

Charter shareholders did not directly rely on Respondents' conduct, as is required under *Central Bank*. 511 U.S. at 180 (declining to permit Section 10(b) claim for aiding and abetting, as it would impose liability "without any showing that the plaintiff relied upon the aider and abettor's statements or actions.") Shareholders allegedly were deceived by, and relied on, Charter's misreporting of certain transactions, including those transactions in which Respondents participated. Charter's shareholders cannot claim that they

were deceived by the transactions themselves, because they do not claim they were even aware of Respondents' transactions with Charter.

Nor were Petitioner's losses caused by the conduct of the Respondents, as the PSLRA requires. 15 U.S.C. § 78u-4(b)(4) ("the act or omission *of the defendant* alleged to violate this title caused the loss." (emphasis added)) *See also Dura Pharm, Inc. v. Broudo*, 544 U.S. 336, 346 (2005) (rejecting recovery under section 10(b) "where these two traditional elements [of causation and loss] in fact are missing.") As Petitioner concedes, Charter's stock price was affected not by the transactions in which Respondents participated, but by the manner in which Charter reported those transactions in its publicly-filed financial statements. (*E.g.*, Br. for Pet'r at 15)

And it was Charter, not Respondents, that allegedly misreported the challenged transactions in order to inflate its stock price, thereby "use[ing] or employ[ing]" a deceptive device "in connection with the purchase or sale of any security" as the plain language of Section 10(b) requires.

For these reasons, there can be no primary liability against Respondents in this case unless the elements of a Section 10(b) claim, including reliance and loss causation, are effectively ignored. This Court was unwilling to do that in *Central Bank* and the same result should obtain here.

A finding of primary liability here would also violate another fundamental precept recognized in *Central Bank*: the securities laws should be interpreted to promote certainty and predictability because these characteristics are critical to the fair and efficient functioning of the U.S. securities markets. As the Court stated:

> As an initial matter, the rules for determining aiding and abetting liability are unclear, in "an area that demands certainty and predictability."

> Pinter v. Dahl, 486 U.S. at 652. That leads to the undesirable result of decisions "made on an ad hoc basis, offering little predictive value" to those who provide services to participants in the securities business. *Ibid.* "Such a shifting and highly fact-oriented disposition of the issue of who may [be liable for] a damages claim for violation of Rule 10b-5" is not a "satisfactory basis for a rule of liability imposed on the conduct of business transactions." Blue Chip Stamps, 421 U.S. at 755.

511 U.S. at 188.

Indeed, the "purpose and effect" test proposed by Petitioners would inevitably lead to fact-based and subjective determinations regarding why two companies completed a transaction. The resulting *ad hoc* decisions, based on almost imperceptible distinctions, will offer little predictive value to other companies wishing to engage in business transactions with U.S. public companies.

In particular, it will be nearly impossible for parties to reliably predict the circumstances under which a court will find that parties entered into a transaction whose "principal purpose and effect" was to inflate the U.S.-listed company's financials. On what side of the line would otherwise legitimate transactions entered into for tax purposes fall? What would become of parties who participate in discounted sales or sales of assets just before year-end? Even where the transactions are legitimate sales, would the timing of the transaction just before the end of a financial reporting period suggest to a court that the transaction had the principal purpose and effect of inflating financial results? What about the thousands of legitimate securitized transactions entered into each year that follow all of the relevant legal and accounting rules, but are done to remove an asset from an issuer's balance sheet? The variations are endless and there is

little doubt that U.S. courts, as well as parties to legitimate business transactions around the world, would struggle mightily with these questions.

A test for liability that raises such questions is unacceptable. Indeed, this court's major opinions in the area of implied rights under Section 10(b) all require clear rules and well-defined contours in order to avoid market inefficiencies and litigation abuses. *See, e.g., Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740 (1975) (limiting private Section 10(b) actions to actual "purchasers or sellers," lest persons be encouraged to bring lawsuits that have "settlement value to the plaintiff out of any proportion to its prospect of success") *Ernst & Ernst,* 425 U.S. at 214 n. 33 (limiting private Section 10(b) actions to those in which defendants possess the requisite scienter, noting that failure to limit the claim in this way would "extend to new frontiers" the reach of Section 10(b) and would raise "serious policy questions not yet addressed by Congress"). *See also Virginia Bankshares* v. *Sandberg*, 501 U.S. 1083, 1110 (1991) (Scalia, J., concurring) ("I think the federal cause of action at issue here [under Rule 14a-9 of the SEC's proxy rules] was never enacted by Congress . . . and hence the more narrow we make it (within the bounds of rationality) the more faithful we are to our task."). In light of these concerns, the expansion of an implied right of action under Section 10(b) is a matter best left to Congress, and the Eighth Circuit's ruling on Section 10(b) liability should stand.

Were the Court to decide otherwise, a foreign company doing business with a U.S. public company would be forced to consider the possibility of false accounting every time it engaged in a transaction. Companies do not customarily inquire into their counterparties' accounting judgments, but even if it were practical to do so, most foreign companies apply the accounting standards of their home countries. They simply do not have (and cannot be expected to employ) sufficient expertise to evaluate the accounting treatment

proposed by a U.S. public company, which would have to be in accordance with U.S. Generally Accepted Accounting Principles ("GAAP").

In the end, Petitioner's version of "scheme" liability will inject into the United States's carefully considered securities law enforcement system an unpredictable and potentially arbitrary mechanism for determining liability. And that mechanism would be placed in the hands of the class action bar, not the SEC. That combination creates precisely the litigation risk that discourages foreign companies from doing business in the United States. Commentary, *Down on the Street*, ECONOMIST, Nov. 23, 2006 (*available at* http://www.economist.com/business/displaystory.cfm?story_id=8316406) ("Many businessmen regard America's legal system, with its punitive jail terms and class-action lotteries, even less favourably than they view Sarbanes-Oxley.").

II. PETITIONERS' PROPOSED "SCHEME LIABILITY" WILL DETER FOREIGN COMPANIES FROM DOING BUSINESS WITH U.S. COMPANIES

There is a widely acknowledged perception, backed by empirical evidence, that a hostile U.S. litigation environment materially increases the costs and risks associated with raising capital in the U.S. markets. Several recent studies demonstrate that this environment is a driving force behind the precipitous decline in U.S. capital market activity.

The introduction of scheme liability to the legal landscape could have a similar impact on the level of general commercial activity between foreign companies and U.S. public companies. This is so because scheme liability not only exposes those who engage in commercial transactions with U.S. issuers to liability for the issuer's misrepresentations, but also increases the likelihood that the silent counterparty could be held liable for scheme-wide

damages far in excess of those that can be traced to the counterparty's conduct.

This fact is powerfully illustrated in the *Stoneridge* case. Here, although Respondents participated in transactions representing less than 4% of the artificial inflation alleged, the Petitioners seek to hold Respondents liable for all alleged shareholder losses – approximately $7 billion.

As this Court has previously recognized, these kinds of outsized damages claims almost inevitably result in huge settlements, regardless of the substantive merits of the case. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 80-81 (2006) (citing *Blue Chip Stamps v. Manor Drug Stores* for the proposition that "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.")

Confronted with such unpalatable realities, counterparties both foreign and domestic will either decline to engage in transactions with U.S. issuers or will do so only after engaging in a *de facto* audit of their counterparties' intended accounting and reporting. Foreign companies, in particular, are ill-suited to this gatekeeper role. The legal structures in the world's other major financial centers vigorously protect their investors and their markets, but do not impose such illogical burdens. And there is no reason to believe that the U.S. Congress, when it refused to restore a private right of action for aiding and abetting under Section 10(b), intended the United States to be an exception among its peers.

A. Recent Studies Indicate that Foreign Companies Will Be Deterred from Engaging in Business Transactions with U.S. Public Companies

In the past year, three separate, highly publicized reports[4] analyzed the precipitous decline in the competitiveness of U.S. capital markets and the rise of alternative markets and exchanges in countries around the world, most notably in the United Kingdom.[5] All three reports concluded that one critical cause of the decline in U.S. competitiveness is foreign companies' fears of being drawn into shareholder lawsuits.

The sanctioning of scheme liability would greatly exacerbate the concerns of the international business community, as it would directly target not just companies that deliberately choose to list themselves on the U.S. exchanges,

---

[4] U.S. Chamber of Commerce, *Commission on the Regulation of U.S. Capital Markets in the 21st Century: Report and Recommendations* (Mar. 2007) (*available at* http://www.uschamber.com/publications/reports/0703capmarketscomm.htm); Michael R. Bloomberg and Charles E. Schumer, *Sustaining New York's and US' Global Financial Services Leadership* (Jan. 22, 2007) (*available at* http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf); Committee on Capital Markets, *Interim Report of the Committee on Capital Markets Regulation* (Nov. 30, 2006) (*available at* http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf).

[5] The statistics are compelling. In 2000, 50% of dollars raised by international companies outside of their home markets were raised on a U.S. exchange. *Interim Report of the Committee on Capital Markets Regulation*, at 2. By 2005, only 5% of these dollars were raised on a U.S. exchange, with 24 of the 25 largest IPOs completed in markets outside the United States. Senate Republican Policy Committee, *Excesses Threaten U.S. Competitiveness, When Excess Damages Success: Have Litigation, Taxation, and Regulation Gone Too Far*, June 19, 2007, at 2. In 2006, that was the case for 23 of the 25 largest IPOs. Id.

but any and all counterparties to general commercial transactions with U.S.-listed companies. Consequently, the hostile litigation environment that has discouraged foreign companies from raising capital in the U.S. markets would, with the addition of scheme liability, undoubtedly have a similarly chilling effect on the willingness of foreign companies to conduct a wide range of commercial transactions with U.S. issuers.

Indeed, the report commissioned by New York City Mayor Michael Bloomberg and Senator Charles Schumer ("Bloomberg/Schumer Report") has found that the threat of securities litigation already is proving a deterrent to foreign companies that wish to "do business in the United States." *Bloomberg/Schumer Report*, at 101. A closer examination of the report suggests that scheme liability would greatly exacerbate these concerns.

In attempting to understand what drives U.S. competitiveness, McKinsey & Company, on behalf of Mayor Bloomberg and Senator Schumer, personally interviewed more than 50 financial industry CEOs and business leaders, received surveys from an additional 30 financial services CEOs in the United States, and separately polled 275 additional global financial services senior executives. *Id.* at 8. McKinsey also interviewed representatives of investor, labor and consumer groups and interviewed and worked with leaders and subject matter experts in the regulatory, legal and accounting professions. *Id.* Through these interviews and surveys, McKinsey identified several factors that dominated the survey participants' views of the business environment in New York, and by extension, the United States.

"[A] fair and predictable legal environment" was among the most important factors considered (ranked behind only the skill of the labor force), and in this regard the United States is commonly perceived to be at a significant disadvantage. *Id.* Indeed, not a single survey participant believed that the legal

environment of the United States presented an advantage over its primary competitors. *Id.* at 75.

Two perceptions figure into this assessment. First, the United States is viewed as overly litigious. Unfortunately, the facts support the perception. Some estimates put the cost of the U.S. tort system in 2004 at $260 billion, which is double 1990 levels. *Id.* at 74. Perhaps more troubling, the growth rate of these costs has accelerated in recent years. Whereas tort system costs grew at 3 percent per year between 1990 and 2000, the growth rate reached 10 percent annually from 2000 to 2004. *Id.*

Securities lawsuits drive a meaningful portion of these costs. One recent study concluded that the average public company has nearly a 10 percent probability of facing at least one shareholder class action lawsuit over the course of a five-year period. *Interim Report of the Committee on Capital Markets Regulation*, at 74 (citation omitted). Foreign companies are acutely aware of these odds. In 2003, for example, China's largest insurance company, China Life, listed on the New York Stock Exchange. Financial Times, Nov. 18, 2005, p. 17. Within three months, the company was the subject of civil lawsuits and an SEC investigation over the accuracy of its pre-IPO disclosures. *Id.* China Life's experience served as a cautionary tale to other foreign companies, and is widely viewed as having driven many Asian companies from the U.S. capital markets. *See, e.g., Hong Kong poses threat to New York as global financial service leader*, Euromoney Institutional Investor, Nov. 1, 2006, p. 49.

These securities suits are not only frequent, but also ever more costly. The total bill for settlements of securities-related lawsuits in 2005 was $3.5 billion – $9.8 billion if the WorldCom settlement is included. *Bloomberg/Schumer Report* at 74. This amount was more than 15 percent higher than in 2004, and 70 percent higher than in 2003. *Id.* By

2006, the average settlement in securities-related litigation was $62.3 million, an astonishing 45 percent increase over the $27.8 million average settlement in 2004. *Id.* at 75. Foreign issuers have not been spared from this trend, as the total settlement value of private securities claims brought against foreign issuers almost tripled from $495 million in 2003 to $1.35 billion in 2005. In 2006, this amount further increased to $2.4 billion.[6] PricewaterhouseCoopers 2006 Securities Litigation Study at 62 (*available at* http://www.pwc.com/extweb/pwcpublications.nsf/docid/a89d7b2aa156e4f1852572ce005bbd54).

Scheme liability would increase both the frequency and cost of securities litigation. First, the theory of scheme liability was created specifically to draw in deep-pocketed secondary actors where the primary actors (for example, the bankrupt issuer and its officers and directors) cannot satisfy the anticipated judgment. Second, almost every scheme liability case involves an allegation that the secondary actor engaged in "knowing" conduct and, under the PSLRA, is jointly and severally liable not only for its own conduct, but also for the conduct of all other "schemers," even where the secondary actor did not participate in or even know about others' conduct. The prospect of joint and several liability for others' conduct greatly enhances the pressure on a secondary actor defendant and, in turn, the likelihood and magnitude of a settlement.

The second perception impacting the assessment of the U.S. legal environment relates to its perceived fairness and predictability. Only 15 percent of CEOs surveyed in the Bloomberg/Schumer Report felt that the U.S. system was more predictable and fairer than that of other countries.

---

[6] The increase in total settlement value for foreign issuers in 2006 is attributable primarily to two settlements entered into by Nortel Networks, which totaled $2.2 billion.

Indeed, many corporations now choose English law to govern their international commercial contracts, rather than the law of the United States, precisely because they view English law as more predictable. *Id.* at 77.

As discussed above, the contours of scheme liability are particularly ill-defined and therefore would create a materially more uncertain environment for foreign companies wishing to do business with U.S. public companies. The United States possesses the strongest criminal and regulatory enforcement regime in the world.[7] This regime acts as a powerful deterrent to wrongful aiding and abetting conduct. Petitioner's scheme liability theory would represent a step back from the strong regulatory enforcement regime designed by Congress and a step toward the unpredictable liabilities and coercive settlements that go hand in hand with private securities litigation.

B. Commentators at Home and Abroad Agree that Petitioners' Approach to "Scheme Liability" Would Deter Foreign Companies from Engaging in Transactions with U.S. Companies

Senior U.S. government officials, as well as foreign and domestic commentators, recognize that the scheme liability rule proposed by Petitioners could have a chilling effect on significant aspects of the U.S. economy. In testimony before the House Committee on Financial Services, U.S. Treasury Secretary Henry M. Paulson observed:

---

[7] Just as the SEC has authority to pursue aiders and abettors, so too does the Department of Justice, which has parallel enforcement jurisdiction under the Securities Exchange Act of 1934 (15 U.S.C. § 78u (h)(9)(B)), as well as 18 U.S.C. § 2.

> The principle [at stake in the *Stoneridge* case] that is important to me is in terms of competitiveness and is important to people on both sides of the aisle. When Senator Schumer and Mayor Bloomberg did a study and looked at our capital markets and the impact on our economy, what did they cite? Excessive litigation risk as a big issue.... And so my concern here is by exposing all sorts of third parties that happen to do business with a public company to primary liability, exposing third parties to that primary liability without clear lines is a risk to our economy, to our competitiveness, to jobs.

The State of the International Financial System: Hearing Before the H. Comm. on Financial Services (2007) (Testimony of Henry Paulson) (*available at* http://financialserv.edgeboss.net/wmedia/financialserv/hearing062007.wvx); *see also* Stephen Labaton, *Investors' Suits Face Higher Bar, Justices Rule*, N.Y. TIMES, June 22, 2007, at A1. C. Boyden Gray, the U.S. ambassador to the European Union, summarized these risks: "If there's a choice between doing business with a company that is listed in New York or one that is not, you would go with the one that was not. It's just not healthy for the transatlantic investment climate." Tim Shipman, *Stoneridge Court Case Threatens Trade with U.S.*, SUNDAY TELEGRAPH, July 7, 2007 (*available at* http://www.telegraph.co.uk/news/main.jhtml?xml=/news/2007/07/08/wlitig108.xml).

Former U.S. Attorney General Dick Thornburgh, who served as court-appointed Examiner in the WorldCom bankruptcy cases, also acknowledged the "dangerous 'ripple effects' if businesses were discouraged from dealing with public companies because they might be sued as 'aiders and abettors' of someone else's fraud." Dick Thornburgh, Commentary, *Class Action Gamesmanship*, WASH. TIMES,

June 15, 2007, at A14. He recognized that unless these lawsuits can be dismissed before trial, they will lead to "exorbitant settlements that have little or no relation to each defendant's legal liability" since most counterparty defendants will decide that the risks and costs associated with litigating the scheme case are simply too high. *Id.*

He further endorsed Congress' decision to leave the policing of aiders and abettors to the Justice Department and the SEC, rather than to class action lawyers who "game the legal system to extort exorbitant settlements from business and professionals who deal with a public company that goes under." Id.

Other commentators have echoed this view. *See, e.g., The Stoneridge Showdown*, ECONOMIST, June 16, 2007 (*available at* http://www.economist.com/finance/displaystory.cfm?story_id=9340553) ("An unfavorable ruling [in this case] would send a chill through boardrooms, and not only in America...[because] it would no longer even be necessary to issue shares in the United States to incur securities liability...Any firm, anywhere, doing business with American companies would have to live with the risk that the transaction could later be portrayed as fraudulent or deceptive. And painting such pictures is what trial lawyers do best.").

Commentators abroad are particularly interested in this case, viewing it as a bellwether of the litigation environment in the U.S. In the respected German newspaper *Boersenzeitung*, editors noted that to avoid the risks associated with Appellant's approach to scheme liability, "businesses dealing with listed companies in the U.S. would have to examine the possibility of a false booking in every transaction, which is practically impossible. This would put into question basic elements of doing business, such as legal certainty and forseeability." Editorial, *Transatlantische*

Beziehungen in Gefahr [*Transatlantic Relations in Danger*], BOERSENZEITUNG, June 28, 2007, at 14.

The editors also observed that "transatlantic business relations would be burdened by significant additional costs stemming from misunderstood investor protection" and that adoption of scheme liability would be perceived to be at odds with the spirit of the April 2007 U.S.-E.U. Economic Summit at which the parties agreed to work towards the "harmonization of . . . the regulatory environment for capital and financial markets." *Id.* The editors concluded that scheme liability therefore poses a "danger of dramatic damage to the transatlantic economic relations." *Id.*

These concerns were echoed in an article in the leading German business daily newspaper *Handelsblatt*, which suggested that foreign companies will be specifically targeted in scheme liability lawsuits due to their unfamiliarity with U.S. law. *A Wave of U.S. Class Actions Threatened*, HANDELSBLATT, Aug. 1, 2007, at 19. A Freshfields Bruckhaus Deringer lawyer quoted in the article insisted that "[o]ne would need to advise clients to meticulously check whether payments made to the US business partner are being reported correctly by the business partner" and that the scheme theory would "introduce a standard of care which would be impossible to satisfy." *Id.*

Indeed, several senior executives of foreign corporations recently emphasized that the cost and risk of litigation is a substantial barrier to doing business in the United States, explaining that "litigation is a greater disincentive to doing business in the U.S. than fears that a protectionist Congress might impose new barriers to foreign trade and investment." Ian Swanson, *Foreign Executives Press for Reform of Litigation in United States,* THE HILL, May 18, 2007, at 11.

C. Foreign Countries Do Not Follow the Approach to Scheme Liability Advocated by Petitioners

The failure to adopt scheme liability would not signal laxness on the part of the United States. To the contrary, the laws of the world's other major financial centers do not provide for the counterparty liability proposed by Petitioners here. These jurisdictions have established systems that comprehensively safeguard investor rights without resort to the unpredictable and unprincipled civil exposure at issue in this case.

As set forth below, these countries have established clear lines for civil liability under their securities laws. Generally, they do so typically by explicitly identifying categories of persons or entities that can be sued in the event of a misstatement. In a case involving a commercial transaction where a counterparty misreports the transaction in its financial statements, generally only the misrepresenting issuer, along with the responsible officers, directors and auditors, can be liable. Silent counterparties are not liable for the misstatements of the issuer.

1. United Kingdom

The Financial Services and Markets Act of 2000 ("FSMA") is the main piece of legislation governing financial services in the United Kingdom. The FSMA contains provisions akin to Section 10(b) that impose civil liability for untrue or misleading statements made in offering documents, publicly disclosed financial reports or statements, and other documents that an issuer must make publicly available. Section 90, FSMA.

Under these provisions, issuers, as well as directors or other persons discharging managerial responsibilities in relation to such issuers, may be liable for any false or misleading

statements contained in these documents. Section 90, FSMA. Liability is not imposed by statute or regulation on third parties that enter into transactions with the issuer which the issuer then misreports.

2. Canada

Securities regulation in Canada is a matter of provincial law. There are minor differences between the various provincial regulatory schemes. However, Ontario is Canada's business capital and home to the Toronto Stock Exchange. Thus, the overwhelming majority of corporations subject to Canadian securities law are subject to Ontario's *Securities Act* (the "Act").

In connection with "primary market misrepresentations" – statements made in prospectuses, offering memoranda and take-over circulars – only the issuer, the underwriters, the directors of the issuer, those who signed the prospectus or circular, and those "whose consent to disclosure of information in the prospectus has been filed pursuant to a requirement of the regulations," can be held civilly liable under the Act.[8] R.S.O. 1990, c. S.5 ss. 130, 130.1 and 131. There is no provision that would hold any third-party (including counterparty to a misreported transaction) civilly liable for the misrepresentation.

The Act also provides for liability in the context of misrepresentations made in other "secondary market" materials, such as annual or quarterly fillings and certain press releases. Like the primary market regime, the secondary market regime is limited to certain actors: the issuer; in the case of a misrepresentation in an oral statement, the person who made the statement; every director of the

---

[8] In the case of an offering memorandum, there only exists a cause of action against the issuer. In the case of a take-over circular the persons liable are the same as in the case of a prospectus, with the offeror stepping into the role of the issuer. *Id.* at § 131.

issuer; every officer of the issuer, if they "authorized, permitted or acquiesced" to the misrepresentation or failure to disclose; every influential person who knowingly influenced the misrepresentation or failure to disclose, where an influential person is, essentially, a person with control over the issuer, an insider or, if the issuer is a mutual fund, a fund manager; and experts (accountants, auditors, lawyers and the such) where the misrepresentation made is included in their report, that report is included or summarized in a document containing misrepresentations, and the expert consented, in writing, to the use of the report. R.S.O. 1990, c. S. 5 s. 138.3.

As with the primary market liability scheme, there is no provision in the Act to hold any other party liable for another's secondary market violations.

3. Germany

The German Securities Trading Act (the "WpHG") contains the principal statutory provisions governing capital markets activity in Germany. Similar to their counterparts in the UK and Canada, these provisions limit liability for misstatements to the issuer and, potentially, certain directors and officers of the issuer. WpHG, Section 37(b), (c). They do not provide for claims against silent third-parties to commercial transactions that the issuer misreports.

CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted,

STUART J. BASKIN*
HERBERT S. WASHER
ADAM S. HAKKI
SHEARMAN & STERLING LLP
599 Lexington Avenue
New York, NY 10022
(212) 848-4000
Attorneys for Amici
*Counsel of Record

August 15, 2007